

FDIC State Profile

Spring 2006

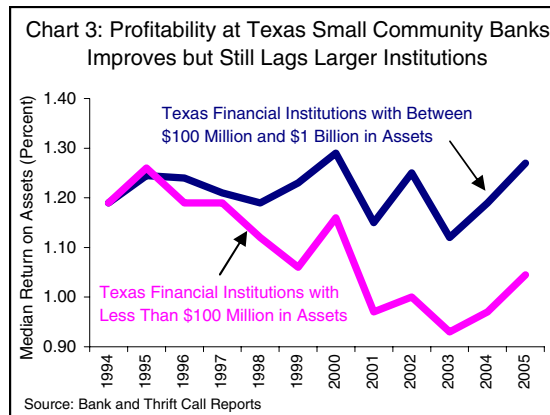
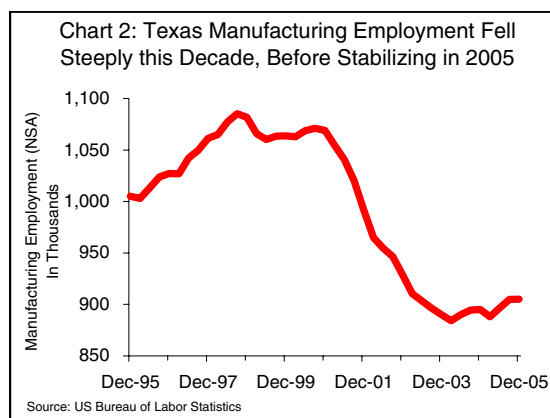
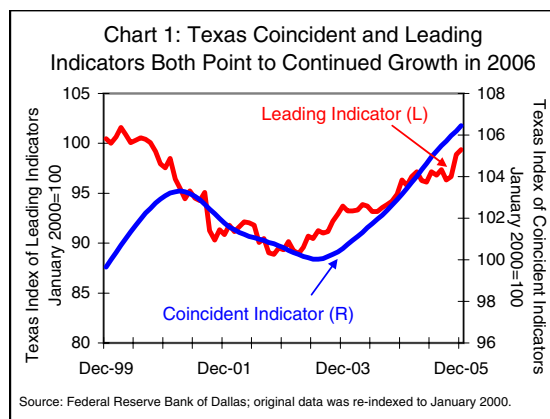
Texas

Employment revisions reveal a more robust Texas economy.

- Recent revisions by the U.S. Bureau of Labor Statistics have placed 2005 Texas employment growth at 2.5 percent, for a net gain of 237,900 jobs. The new job numbers were significantly higher than previously estimated, depicting a much stronger Texas economy. Indeed, the revisions showed the state growing over a percentage point faster accounting for an additional 100,000 plus net jobs.
- Most major sectors of the Texas economy are expanding, except for the information and other services sectors. The information sector, primarily telecommunications, is still troubled by cost restructuring, overcapacity, and weak demand. Meanwhile, the professional and business services and education and health services sectors figure to be major sources of employment for Texans in 2006.
- Current state economic indicators point to continued solid growth for the Texas economy in 2006. For instance, the Texas coincident and leading indicators (see Chart 1) have accelerated over the past year.¹ Moreover, the Texas *Business Leaders Confidence Index* (BLCI) rebounded strongly in first quarter 2006 after dipping slightly in fourth quarter 2005 because of lingering concerns surrounding the aftereffects of Hurricane Katrina and Rita.² Business leaders across the state in a broad range of industries now view the outlook for the Texas economy as strong, with rising sales and profits fueling greater hiring and capital expenditures.

Goods-producing industries should provide a major lift to the state's economy.

- The goods-producing sectors of manufacturing, construction, and natural resources and mining experienced severe employment losses during or following the 2001 recession. The manufacturing sector, in particular, has suffered enormously losing 16 percent of



¹The Texas leading and coincident indicators are produced by the Federal Reserve Bank of Dallas and can be found at <http://www.dallasfed.org/data/data/leadi.htm> and <http://www.dallasfed.org/data/data/coini.htm>.

²"Business Leaders Confidence Index (BLCI), Texas, First Quarter 2006," Volume 5, Number 1. https://www.bcli.com/texas/pdf/bcli_tx_2006_q1.pdf

its employment base between first quarter 2001 and first quarter 2005 (see Chart 2). However, 2006 may prove to be a turning point for these sectors as the Texas economy gathers momentum and once again exceeds the U.S. economy in output and employment growth.

- Energy prices are forecast to remain high throughout 2006 supporting employment gains in the state's important oil and natural gas industry.³ Drilling rig activity in Texas soared 23 percent between February 2005 and February 2006.⁴ A major beneficiary of the strong energy sector will be the **Houston** economy, which is perhaps the healthiest of the state's large metropolitan areas.
- The state's construction sector is expected to move countercyclically with regard to the nation's construction sector in 2006. The U.S. housing market, including home price growth, is forecast to slow this year because of rising mortgage rates and higher home inventories.⁵ However, Texas housing activity is expected to strengthen somewhat in 2006, supported by strong demand fundamentals in employment and income growth. Not only are homebuilding and sales activity expected to stay near record highs, but home price appreciation in several of the state's large metropolitan markets may also be poised to accelerate.⁶

Solid 2005 results suggest institutions have benefited from higher short-term interest rates.

- Banks and thrifts headquartered in Texas posted a median return on assets of 1.14 percent for calendar year 2005, the highest rate since the 2001 recession and higher than the national average of 1.04 percent.
- Improving credit quality has allowed provision expenses to remain at decade-low levels, but there is little room for further declines in this expense category.
- The strong positive correlation between short-term interest rates and median net interest margins (NIM) at Texas financial institutions suggests that the state's institutions have been relatively asset sensitive, and have therefore benefited from recent short-term interest rate hikes. However, the yield curve is flattening and the yield curve spread is at its lowest level since first quarter 2001. Historically, this condition has created challenges for

bank earnings and implies increasing pressure on margins going forward.

- The median cost of funds for Texas insured institutions was 1.79 for fourth quarter 2005, ranking fourth lowest nationwide. Texas institutions tend to hold higher levels of noninterest bearing deposits and enjoy a relatively high percentage of funding from core sources (seventh highest in the nation).⁷ Additionally, more than half of the state's insured institutions are in rural areas that often have fewer market competitors and provide bankers with greater influence in determining interest rates for both loan and deposit products.

The divide in profitability between large and small financial institutions remains.

- More than half of all insured institutions in Texas hold less than \$100 million in assets, and earnings for these institutions are driven in large part by NIM. Many of these community financial institutions have benefited from the recent increase in short-term interest rates.
- The median return on assets ratio for large community institutions (assets between \$100 million and \$1 billion) was 1.27 percent for the year ending December 2005, compared with 1.05 percent for small community institutions (less than \$100 million in assets). This trend has been prevalent for the past decade (see Chart 3).
- While small community banks tend to have higher NIMs, large community banks earn more noninterest income and enjoy lower overhead costs due to greater economies of scale.

³Energy Information Administration's Short-Term Energy Outlook, February 7, 2006, release which can be found at <http://www.eia.doe.gov/emeu/steo/pub/contents.html>.

⁴Rig count numbers supplied by Baker Hughes can be found at http://www.bakerhughes.com/investor/rig/rig_na.htm.

⁵National Association of Realtors' U.S. Economic Outlook: January 2006, [http://www.realtor.org/Research.nsf/files/currentforecast.pdf/\\$FILE/currentforecast.pdf](http://www.realtor.org/Research.nsf/files/currentforecast.pdf/$FILE/currentforecast.pdf).

⁶According to Fiserv Lending Solutions' February 2006 House Price Forecast found at http://money.cnn.com/2006/02/02/real_estate/house_price_predictions_for_2006/index.htm.

⁷Core funding includes checking, savings, and small certificates of deposit and are typically considered to be a more stable source of funding than non-core funding (brokered deposits, borrowings, etc).

Texas at a Glance

ECONOMIC INDICATORS (Change from year ago, unless noted)

Employment Growth Rates	Q4-05	Q3-05	Q4-04	2004	2003
Total Nonfarm (share of trailing four quarter employment in parentheses)	2.9%	2.6%	2.0%	1.3%	-0.5%
Manufacturing (9%)	1.1%	1.1%	0.6%	-1.0%	-5.1%
Other (non-manufacturing) Goods-Producing (8%)	6.3%	5.6%	1.3%	-0.1%	-2.1%
Private Service-Producing (66%)	3.1%	2.7%	2.4%	2.1%	0.0%
Government (17%)	1.7%	1.8%	1.3%	0.6%	1.2%
Unemployment Rate (% of labor force)	5.3	5.3	5.6	6.0	6.7

Other Indicators	Q4-05	Q3-05	Q4-04	2004	2003
Personal Income	N/A	7.7%	7.3%	6.0%	3.9%
Single-Family Home Permits	26.4%	17.5%	5.7%	8.3%	9.3%
Multifamily Building Permits	2.1%	33.9%	-21.2%	-12.9%	5.4%
Existing Home Sales	6.2%	13.9%	11.8%	14.1%	3.2%
Home Price Index	5.5%	5.5%	3.9%	3.1%	3.2%
Nonbusiness Bankruptcy Filings per 1000 people (quarterly annualized level)	6.64	5.31	3.92	4.03	4.01

BANKING TRENDS

General Information	Q4-05	Q3-05	Q4-04	2004	2003
Institutions (#)	661	672	681	681	697
Total Assets (in millions)	237,632	229,449	215,455	215,455	200,187
New Institutions (# < 3 years)	24	24	24	24	20
Subchapter S Institutions	257	264	262	262	259

Asset Quality	Q4-05	Q3-05	Q4-04	2004	2003
Past-Due and Nonaccrual Loans / Total Loans (median %)	1.51	1.52	1.77	1.77	2.04
ALLL/Total Loans (median %)	1.20	1.20	1.23	1.23	1.27
ALLL/Noncurrent Loans (median multiple)	2.41	2.37	2.14	2.14	1.91
Net Loan Losses / Total Loans (median %)	0.12	0.08	0.13	0.14	0.18

Capital / Earnings	Q4-05	Q3-05	Q4-04	2004	2003
Tier 1 Leverage (median %)	9.53	9.68	9.42	9.42	9.07
Return on Assets (median %)	1.10	1.20	1.00	1.04	1.02
Pretax Return on Assets (median %)	1.37	1.52	1.24	1.33	1.28
Net Interest Margin (median %)	4.50	4.50	4.40	4.22	4.21
Yield on Earning Assets (median %)	6.34	6.11	5.62	5.44	5.59
Cost of Funding Earning Assets (median %)	1.79	1.60	1.17	1.10	1.33
Provisions to Avg. Assets (median %)	0.10	0.10	0.12	0.12	0.16
Noninterest Income to Avg. Assets (median %)	0.86	0.90	0.88	0.91	0.93
Overhead to Avg. Assets (median %)	3.49	3.43	3.55	3.41	3.36

Liquidity / Sensitivity	Q4-05	Q3-05	Q4-04	2004	2003
Loans to Assets (median %)	56.5	57.9	56.7	56.7	53.8
Noncore Funding to Assets (median %)	17.3	17.5	16.8	16.8	16.3
Long-term Assets to Assets (median %, call filers)	11.7	11.6	13.3	13.3	13.8
Brokered Deposits (number of institutions)	104	101	79	79	76
Brokered Deposits to Assets (median % for those above)	4.1	3.6	3.7	3.7	2.8

Loan Concentrations (median % of Tier 1 Capital)	Q4-05	Q3-05	Q4-04	2004	2003
Commercial and Industrial	83.9	84.2	84.7	84.7	85.8
Commercial Real Estate	155.9	159.1	152.8	152.8	144.8
<i>Construction & Development</i>	31.7	29.9	26.8	26.8	26.5
<i>Multifamily Residential Real Estate</i>	1.7	1.9	1.8	1.8	2.0
<i>Nonresidential Real Estate</i>	114.9	109.9	108.5	108.5	98.4
Residential Real Estate	93.8	95.6	99.5	99.5	102.8
Consumer	58.1	60.5	64.6	64.6	70.9
Agriculture	33.4	35.1	35.2	35.2	32.5

BANKING PROFILE

Largest Deposit Markets	Institutions in Market	Deposits (\$ millions)	Asset Distribution	Institutions
Dallas-Fort Worth-Arlington, TX	176	113,409	< \$250 million	537 (81.2%)
Houston-Baytown-Sugar Land, TX	109	99,753	\$250 million to \$1 billion	87 (13.2%)
San Antonio, TX	58	31,249	\$1 billion to \$10 billion	33 (5%)
Austin-Round Rock, TX	64	15,749	> \$10 billion	4 (0.6%)
McAllen-Edinburg-Pharr, TX	17	6,791		